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WEEKLY SUMMARY

Special Report

The European Communities: A Monetary Union

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THE EUROPEAN COMMUNITIES: A MONETARY UNION

Developing the European Communities (EC) into a true economic and monetary union is likely to be the major internal preoccupation of the Community membership for the next decade—and probably well beyond. With the national economies of the member states increasingly interdependent as a result of the customs union, the common agricultural policy, and other measures the Common Market has put into effect, all the member states recognize the need for at least a greater measure of coordination of fiscal, monetary, and budgetary policies at the Community level. Otherwise, trade and capital flows will be disrupted by restrictive measures reimposed at the national level whenever a balance-of-payments crisis threatens.

Some of the elements of a future economic and monetary union are already in place, such as the agreement on a common system for certain indirect taxes, the small but growing Community budget, and a great variety of arrangements for monitoring and discussing national economic trends. In the past few months, moreover, the member states appear to have made some headway toward agreement on the broad outlines of a staged program which—beginning with harmonization of national economic policies—would move toward Community-determined policies and perhaps ultimately toward a single currency. Nevertheless, the technical problems involved are formidable, and basic differences in economic philosophies are far from reconciled. Some of the member states continue in fact to believe that, as long as national policies and economic structures remain so different, a too hasty institution of common rules or measures—such as denying the member states the right to resort to exchange controls—would aggravate rather than prevent crises. The basic question involved in bringing about uniform management of economic and monetary policies, of course, is the fundamental, political one of how much power member states are willing to transfer to Community institutions, and how fast.

Under the best of circumstances, this next stage in the evolution of the Common Market will probably be no less difficult or contentious than the transitional period that was completed last January. But—to the members, the candidates for membership, and the other participants in the international monetary system—it will be more important. The question has already been raised of how to relate the Community's current deliberations to the monetary problems that will be posed in a year or so by Britain's prospective accession. Whether new ways can be found to improve the functioning of the international monetary system will depend in good part on the Community's success in consolidating a stable monetary system of its own.

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The Hague Communiqué

The impetus for the present discussion of monetary union arose largely from the agreement reached last December at the "summit" conference of the Six at The Hague to "relaunch" the Communities. The basic elements of that agreement were to accelerate decisions on internal policies and to open negotiations for enlargement. As part of the internal program, the member states recorded their intention, as stated in The Hague communiqué, to develop during the course of 1970 "a plan to be carried out in phases...with the purpose of achieving an economic and monetary union." It was further stated that the "development of monetary cooperation should be based on the harmonization of economic policy." In addition, it was decided "to have investigated the possibility of creation of a European reserve fund which should flow from a common economic and monetary policy."

Monetary Union

What does monetary union mean: Unrestricted and irrevocable freedom of money and capital movements among the participating states, exchange of the member currencies among each other at fixed and unchangeable rates, pooling and joint administration of the foreign exchange reserves, unrestricted operations of all credit and finance institutes in the area of the Community as a whole. Such a monetary union can be kept free of tensions and crises only if aggregate demand in the individual member states were to develop parallel (that means at the same growth rhythm relative to the real growth potential prevailing in the individual member states). Not only credit creation by the local banking systems, but also public spending, as well as wage and other income developments in the economy, would have to be subjected to this parallelness.

—From speech by West German Bundesbank Vice President Otmar Emminger in Bad Godesberg in April 1970

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Economic and monetary union will permit the realization of an area within which goods and services, people and capital will circulate freely and without distortions of competition—without giving rise at the same time to structural or regional imbalances.

—From the Interim Report to the Werner Group to the Council and Commission, May 1970

Background

The monetary objectives adopted at The Hague meeting reflect a Community history of difficulty in coping with balance-of-payments crises. Existing Community mechanisms have thus far lacked both the speed and the resources to deal with losses of reserves resulting from prolonged deficits or sudden speculative runs. The Treaty of Rome makes provision for mutual aid, but the relevant clause—Article 108—proved insufficient as early as 1964 to deal with the payments crisis that developed the same year in Italy. While the Council of Ministers was still debating procedures and conditions for providing aid, the US came to Italy's rescue. Again in 1968, it was international aid, this time from the Group of Ten meeting in Bonn, that met the threat to the French franc resulting from the unprecedented flight from it to German marks and Swiss francs.

With aid available through international arrangements such as that provided by the Group of Ten and the so-called Basle Club of central bankers, the need for credit arrangements within the EC as such has been questioned. Indeed, until recently the view has prevailed among the Six that discussion and examination of monetary and financial policies within the Community would be sufficient to maintain equilibrium, and a host of committees have devoted themselves to this task in the past decade.

The 1968 crisis, however, brought home the disruptive potential of crises arising from sudden and large speculative capital flows—originating in this case predominantly from within the Community itself. Although supplementary aid from extra-EC sources might always be needed,

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Existing Monetary Arrangements in the Community

Budgetary, monetary and credit policies are made through independent decisions by the competent national authorities–treasuries and central banks–and the organs of the Community have little opportunity to intervene. In other words, while it is true that the economic policies are subject to a considerable effort of coordination, it is also true that this process is limited to marginal adjustments. These are designed to make allowance to some degree for the interests of the other member nations without, however, impinging on the policy-making process which takes place essentially on a national scale.

The very provision of the Rome Treaty that each member nation is required to regard its exchange-rate policy as a problem of common interest translates itself in practice into a prior consultation–when it takes place at all–on a parity change decision which has already been made by the national authorities. The countries of the Community are not yet accustomed to discuss the consistency and validity of the existing parities. There has never been a Community consultation, at least on a political level, about the adequacy of the exchange rate of a member country's currency, even when the phenomenon of apparent disequilibrium in the exchange rate existed over a long period of time.

–From remarks by Italian Treasury Minister Emilio Colombo at a meeting of EC finance ministers and central-bank governors in February 1970

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The first two medium-term programs did not generate sufficiently harmonized objectives–a basic condition of effective coordination. Examinations of the short-term situation in the Community have often ended only with recommendations formulated in completely general terms, even when the Community interest would have called for adopting more concrete positions. In general, the consultation procedures have not given the hoped-for results, either because they assumed a purely formal character, or because the member states protected themselves by resorting to escape clauses.

–From the Interim Report of the Werner Group to the Council and Commission, May 1970

Community authorities became convinced that if European integration were to be taken seriously, divergent policies within the Community as a cause of payments crises would have to be taken into account, and some sort of effective support mechanism would have to be developed to give expression to Community responsibility in the future.

Meanwhile, the member states became increasingly conscious that the growing interdependence of their economies meant that the Community as a whole would be more and more susceptible in the future to economic imbalances in one of the member countries. As demonstrated in the monetary crisis of 1968 and the German and French exchange-rate adjustments of 1969, such events can, in the words of a report done for the EC Council in May 1970, "seriously compromise the integration achieved in the fields of freeing movement of goods, services, and capital. This goes particularly for the common agricultural market." It can be argued that temporary restrictions on goods and capital movements do not seriously affect the long-term development of the Common Market, but such measures undoubtedly create a poor psychological climate in which to move forward. This is especially the case when the exceptional measures are not planned emergency procedures but rather are expedients adopted by the member governments and ratified at the Community level after the fact.

Moreover, the possibility of resorting to such expedients has gradually declined as the Community has developed. The growing interpenetration of the economies of the Six has weakened the autonomy of national short-term policies. For example, with trade accounting for an ever-greater proportion of national income in all the Six, national borders are no barrier to inflation. Thus some of the anti-inflationary tools normally used by national governments—such as credit restrictions—can be used by the Community members but with less effect. At the same time, these tools have not been given over even in part to the Community to enable it to deal with Community-wide disequilibrium.

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Still other considerations have inspired increased Community interest in economic and monetary union. Some within the Community have been motivated to support it by a sort of "nationalistic" spirit—for example, as the most effective way of furthering a Community "economic personality" vis-a-vis the world in general and the US in particular. A Community "identity" would presumably be able to deal more effectively with the problems posed by "multinational" companies, uncontrolled "Euro-" markets in dollars and securities, and speculative movements of international capital. All of these postwar phenomena have their positive sides, but they also involve a certain loss of control by the Community members over economic trends.

Finally, some of the present interest in pushing the Common Market into a further stage of integration stems from the purely political objectives that motivated the Community founders in the first place. Economic and monetary union is seen as a way of creating new links between the EC members to supplement the cohesive effect of past measures that for various reasons may not be so binding in the future. In a recent interview, for example, Raymond Barre, the EC Commission vice president responsible for economic and financial affairs, cited the tariff reductions resulting from the Dillon and Kennedy Rounds, the prospective enlargement of the Community, possible tariff reductions with regard to Eastern Europe, and continued high US investments in the EC as developments that have lessened or will lessen the importance of the Community's external tariff wall. Hence, in his view, it is politically essential to find new ways to knit the Community together.

New Commission President on Economic and Monetary Union

No one can deny the purely political character of an undertaking on such a broad scale. No one can believe that such an important political problem can be solved simply by using more or less sophisticated techniques and simply by mobilizing forces belonging to the national and Community administrative bodies. To be achieved, a political objective requires a strategy capable of mobilizing, to as large an extent as possible, the national parliaments, the trends of opinion, the parties, and the trade unions.

—From speech by Franco Maria Malfatti to the European Parliament, July 1970

Commission Initiatives

In the aftermath of the November 1968 crisis, the Commission in February 1969 submitted to the Council a new memorandum entitled "Coordination of Economic Policies and Monetary Cooperation in the Community." This so-called Barre memorandum made suggestions for concerting medium-term economic policies—with respect to rates of growth of production and employment, price trends, balance of current accounts, and over-all balance of payments. It also called for better coordination of short-term policies, and for a Community mechanism for short- and medium-term financial aid. The short-term aspects of the Barre plan were approved in January 1970 and the various medium-term aspects have been or shortly will be submitted as draft decisions for Council approval.

The short-term arrangements, as implemented by the Council, provide credits up to one billion dollars available automatically on application and a further one billion in drawing rights available on a standby basis. The drawings of individual countries from the first billion are limited to the amounts of their quotas—30 percent each for Germany and France, 20 percent for Italy, and 10 percent each for the Netherlands and Belgium-Luxembourg. The second portion is available in theory for any country up to one billion dollars, but in practice the central bankers, whose approval is needed for drawings on this sum, might be reluctant to see one country draw up to the limit. Short-term support is initially for three months; it can be renewed once if agreement is reached on measures the deficit country should take to correct its situation. Moreover, in connection with these arrangements for short-term currency support, the member states are agreed that consultations should take place within the relevant Community committees before any member introduces short-term economic or fiscal measures likely to have repercussions on another.

The principal significance of the short-term agreements was, as Barre had originally intended, to lay the groundwork for medium-term support—and this in turn would make medium-term coordination of policies desirable. Although the short-term programs were accepted by the Six because there were no real alternatives, their shortcomings were widely appreciated at the time. For example, Guido Carli, governor of the Bank of Italy, said shortly after approval of the short-term credits that, despite pledges to the contrary, coordination of economic policies within the EC would be ignored when domestic considerations were strong. He conceded that the short-term credits were better than nothing, but that swap credits with the US Federal Reserve were much more useful in practice, an opinion shared by Italian Treasury Minister Colombo. (In March 1970, the Federal Reserve did grant Italy an additional swap credit of 500 million dollars, with no objections from Italy's EC partners, who were consulted.) Carli's conclusion was that it was doubtful that monetary cooperation and policy coordination could go very far within the EC without strengthened political cohesion.

Medium-term Aid and Policy Coordination

The medium-term arrangements asked for by the Commission are in fact an attempt to achieve some greater degree of political cohesion without having to make a direct attack on the problem of federal unity. Procedurally, its proposal for medium-term (two to five years) financial aid within the Community is intended to flesh out the inadequate and cumbersome guidelines for ad hoc action laid down in Article 108. The mutual assistance provided for in that article is intended to overcome balance-of-payments adjustment difficulties without having to resort to changes in exchange rates or to other measures prejudicial to integration. In contrast with the first portion of the short-term credits arrangement, there is nothing automatic about the proposed aid provided for by the medium-term scheme. Such aid can be extended only by a qualified majority vote in the Council on a recommendation by the Commission and after consultation with the Monetary Committee. Moreover, a qualified majority will decide on the conditions for the loan, including the economic policy commitments of the receiving country. Finally, the medium-term policy would require coordinated action by the Six if one of the member states seeks additional aid from another international organization.

The total sum to be available in principle under the medium-term aid is another two billion dollars, subscribed to in the same proportions as the short-term credits. The Council is scheduled to discuss the assistance scheme this fall, when it presumably will be taken up together with the general question of further steps toward monetary union.

The remaining aspect of the Commission's 1969 memorandum would commit the Community to coordinate medium-term economic policies—that is, rates of growth of production and employment, inflation trends, the balance of current accounts, and the over-all balance of payments. The aim would be to bring to light regional and labor situations of the member states, as well as disparities in the economic structures, and to bring about a convergence of their economic plans and programs, the periods of which now do not always coincide. The Commission's idea is to stimulate action by getting Council approval for medium-term (five-year) statistical projections of each country's GNP, employment trends, rate of inflation, and balance of payments. Since early this year, specific goals suggested by the Commission have been under discussion within the Community. Once agreed by the Council, such projections would presumably serve as terms of reference for national economic policy decisions.

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Unified (or Common) vs. Coordinated (or Harmonized) Economic Policies

...unified economic policies are something much different from merely coordinated economic policies. The latter are defined and worked out on a national level and then compared with the view of possible minor adjustments. Unified economic policies, instead, are defined and worked out on a Community level rather than on a national level....It is hard to imagine the formulation of unified economic policies in the framework of the existing Community structures. Unified economic policies presuppose a continuing dialogue conducted on political and technical levels by bodies sitting with the necessary continuity.

—Emilio Colombo
February 1970

Toward Economic and Monetary Union

Following The Hague summit meeting in December, the EC Council appointed a committee to study the available options for a phased establishment of economic and monetary union. The committee is chaired by Luxembourg's Prime Minister and Finance Minister Werner—a longtime advocate of action in the monetary field—and the members are the chairmen of the five EC committees concerned with economic and monetary matters plus a representative of the Commission. None of these experts necessarily represents the official views of his government. Bernard Clappier, for example, Deputy Governor of the Bank of France and chairman of the EC Monetary Committee, told the US Embassy that he could not function effectively if he had to get formal instructions from the French Government—there being too many differing views in Paris for reconciliation within the timetable under which the Werner Group was working.

In the group's recent discussions the points of reference were four more-or-less specific plans for economic and monetary union offered by Werner himself, Belgian Finance Minister Snoy, West German Economics Minister Schiller, and the Commission. In addition to these plans, Italy's Colombo and German Bundesbank Vice President Emminger had recently made extensive relevant remarks. Also, as part of a study on "Problems of British Entry into the EEC" prepared for the Action Committee for the United States of Europe, Italy's Carli and Yale's influential monetary economist Robert Triffin, respectively, had recently presented cases for mobile parities in an intermediate period of Community monetary integration, and for a European Reserve Fund "to support and ensure within the Community itself the harmonization of monetary policies." The latter idea is also supported by Colombo.

Major Issues

Common to all these specific plans is a transition period to economic and monetary union of from eight to ten years, with movement to take place in from three to seven stages. Moreover, all of them envisage early completion of the Commission's proposals for medium-term financial support and policy-goals agreements. There are, however, four major issues on which the authorities tend to divide: (1) whether the stress ought to be placed first on reaching economic union—involving common policies on budgetary, fiscal, inflation, incomes, and balance-of-payments objectives—rather than on monetary union; (2) whether fixed exchange rates are compatible with differing national goals during the transition to monetary union and, if not, which will give way; (3) whether monetary union is possible without first achieving political union; and (4) how to enlarge the Community membership without impeding progress toward economic and monetary union.

The question of whether to give precedence to monetary or economic integration has assumed the dimensions of a doctrinal dispute despite the efforts of some, notably EC vice president Barre, to dismiss this as a false dilemma and to stress that parallel progress in both areas is necessary. The problem on a technical level seems to be that it may be easier to take certain monetary measures—such as to narrow the band within which exchange rates are permitted to fluctuate or to contribute a portion of national monetary reserves to a common pool—than it is to bring often widely disparate economic policies into line. These differences in national economic policies may in fact reflect such basic factors as differently timed business cycles, different political pressures, different vulnerabilities to external events, and differing exposures to internal trade-union power. Therefore, it could be dangerous, before a true economic union is achieved, to restrict the range of monetary measures and correctives available to the individual states to deal with their respective situations. This—overly simplified—is the position of the so-called "economists" in the debate.

The "monetarists" do not necessarily argue with the assumption that economic integration is inherently slower than monetary integration. But they would contend that monetary integration should provide the stimulus to move ahead, for example, in unifying commodity and capital markets—one of the conditions necessary for unification of economic policies. Werner, who is usually included among the "monetarists," in a January 1968 speech frankly characterized monetary unification as: "...a means of promoting economic integration which is very efficient and even sometimes brutal. It can end by forcing the economy into a new mold at the unfortunate price of tensions and pressures."

The "monetarists" would cite in support of this position the kind of problems that may arise for specific industries when monetary integration lags behind the real industrial integration encouraged by the customs union. An example of these problems is the demarche made to the Commission last June by important aircraft firms from five Community countries. Announcing their own increasing efforts to integrate and asking for Community action to help meet American competition, the firms noted that their cooperation in carrying out long-term programs would be hindered by the absence of guarantees against changes in exchange rates. So long as there is no "European" currency, they argued, exchange guarantees should be established in order to offset distortions resulting from possible changes in monetary parities.

Among the Six, the Germans—in part fearing the "pressures and tensions" to which "premature" monetary arrangements might give rise and in part fearing what they might have to contribute to reserves—represent the "economists' " wing. Schiller's plan, although carefully drafted to link economic with monetary measures in each of its four phases, would in fact require considerable progress toward economic union before monetary mechanisms could be activated. The French for their part have not provided any step-by-step version of their ideas on economic and monetary union, but it is clear that on the political level they emphasize early monetary measures as an earnest of Community "togetherness." Within this spectrum the Belgians and Luxembourgeois generally are closer to the French in stressing monetary elements, and the Dutch and Italians are closer to the Germans in giving higher priority to economic integration. The Commission advocates a parallel approach.

Closely related to the issue of priority of economic vs. monetary union is the question of exchange-rate adjustments. Many advocates of monetary union believe that the best approach is gradually to narrow the margins within which member-state currencies could fluctuate in relation to one another. Ultimately, margins among member-state currencies would be eliminated and the Community would function as a fixed-rate currency bloc with respect to the dollar and other third-country currencies. The French, Belgians, Luxembourgeois, and the Commission would introduce narrower margins at an early stage. The Germans and Italians favor postponing the narrowing of margins until later phases of economic and monetary union.

Those who favor such a delay do so in part because they doubt the early feasibility of correcting every disequilibrium among the member states with the immediate and finely tuned adjustments of national policies that would be required. They would also allow for the possibility that, in the current pattern of exchange rates, some of the currencies may prove to be under- or overvalued. Thus, the Italians advocate a system that would, in Carli's words, "admit, within limits to be decided (2 percent per annum at the most), monthly or quarterly devaluations or revaluations." These would "compensate and correct the disequilibrium persisting in the evolution of national prices and costs, and so maintain a greater stability of competitive conditions." This concept has apparently not found much favor within the Community, although Carli claims that the very *uncertainties* in the exchange market introduced by his scheme would put pressure on governments to accelerate the coordination of their economic policies.

The Commission, on the other hand, believes that to increase exchange-rate flexibility within a budding monetary union is absurd and argues that the greater policy cooperation among the Six resulting from even the early stages of economic and monetary union would serve to make parity changes more "orderly." If policy coordination has not been able to overcome basic imbalances and thus avoid the need for exchange-rate adjustments by the member states during the transition period, resort could be made to the traditional one-time devaluation or revaluation techniques.

Although it is evident that the achievement of all the steps required for effective economic and monetary union would carry the Community very far toward some kind of federal Europe, there is not at this point any disposition to face up to this fact. The "pragmatists," such as the Commission, prefer to speak of the progressive creation of a "functional" economic and monetary union stopping short of an actual federation, which Barre says, "for obvious political reasons would be more difficult to achieve within the same period."

Nevertheless, the question of national vs. Community sovereignty will arise at each stage of the enterprise and become more pressing with each further advance. In connection with the medium-term policy proposals now under discussion, the contentious issue of majority decisions has already been raised. The preference of the French for a certain automaticity in monetary measures is probably related to their distaste for the majority voting that economic policy coordination probably requires if it is to be more than a facade. Moreover, the future powers and responsibilities of the European Parliament—already a sensitive question—can hardly be ignored forever. As the Community moves toward harmonizing economic policies and creating common monetary mechanisms, the member states will be relinquishing to Community councils grave responsibilities while they themselves remain the politically accountable authorities—unless accountability is transferred to the Parliament.

Naturally, none of the member states wishes to face this dilemma squarely, and—depending on the economic and political climate and the skill of the Commission—it may be possible to avoid the kind of confrontation that occurred in 1965 when De Gaulle sought to prevent a further extension of the majority voting scheduled to occur at that time. But the question of how to run an economic union of the Community's dimensions cannot in the long run be left unanswered.

The Werner Group Report and its Reception

The interim report of the Werner Group, as presented to the Council meeting of 8-9 June, sketches the situation at the "point of departure" for economic and monetary union and outlines the scope of the union at the "point of arrival." At the last stage, for example, there would be effective Community organs, having well-defined responsibilities with respect to "democratic rules"; and labor would participate at the Community level in working out an incomes policy. The report then spells out at greater length the

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Barre on Economic and Monetary Union

Obstacles

First, there are technical obstacles: the problem now is not to eliminate quotas or tariffs, but to harmonize the economic, fiscal, monetary and social policies of the member countries and to hammer out common policies in all the fields where they are needed.

Then there are political hurdles to be overcome: the drive to build up our Community is now encroaching on areas directly affecting the responsibility of governments to their parliaments and public opinion. Here we must tread carefully...because we are attempting to align national policies at the very moment when economic, social, intellectual and even moral protest is the order of the day in all our countries.

Finally, there are international difficulties: a Community gradually gathering economic and monetary strength will acquire a new degree of influence. This is bound to change the current system of economic and monetary relations, upon which at the present time no single member state can have anything more than a very limited impact. So it is not surprising that a stronger Community is a source of concern in some parts of the world and is not welcome everywhere.

Favorable Factors

If the Community countries really want to safeguard and increase the agricultural, industrial and commercial advantages of the Common Market...sooner or later they will have to accept, whether they like it or not, a fuller and more effective economic and monetary organization of the Community.

...an organized Community monetary grouping, with its own individuality, within the international monetary system is a growing necessity. For not only must the specific interests of the six countries be safeguarded, but a better balance of forces must be established within the international monetary system ensuring that international monetary cooperation can function harmoniously.

The monetary disturbances which afflicted the community in 1969 and the serious difficulties the international monetary system ran into have made the public more and more sensitive to the internal and international monetary aspects of our community venture: only the specialist can really grasp how the elaborate and sophisticated machinery works, but the public has realized how important it is in practice and in politics.

—From a speech in Bellagio on "The European Economic Community in the '70s," June 1970

proposed actions for the first phase. At its June meeting, the Council "noted with satisfaction" the conclusions of the Werner Group's interim report, and this has been widely taken as signifying Council agreement with the principles outlined. In summary, these state that:

- *the Council must rule before the end of 1970 on medium-term quantitative economic policy guidelines and on the introduction of medium-term financial aid;*
- *the ultimate objective appears attainable within the present decade, provided it receives the permanent political support of the governments;*
- *the necessary powers for economic policy decisions will be transferred from the national to the Community level, and this could eventually lead to a single currency;*
- *action in the transition period will be taken simultaneously and progressively on a number of fronts. Although some measures will require amending the Treaty of Rome, the present provisions already permit substantial progress;*
- *a period of three years from 1 January 1971 for completing the first stage appears suitable from the technical point of view. This stage is intended to render Community instruments progressively effective and to mark the beginning of the Community's "identity" within the international monetary system;*

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–the first stage should include a tightening up of consultation procedures, conducting of budgetary policy by the member states in the light of common objectives, introduction of some degree of fiscal harmonization, close coordination of monetary and credit policies, and stepped up integration of financial markets;

–the Community should progressively adopt common positions in monetary relations with nonmember countries and in international organizations and, in particular, must not avail itself of any provisions that might render the international exchange-rate system more flexible.

How much of this can be accepted as formally "agreed" remains to be seen. The Germans still seem to stress the necessity of progress on effective economic cooperation prior to monetary commitments, and the Dutch may be reluctant to move very far at all before the British are brought into the negotiations. In any case, the Werner Group report itself notes the so-far unreconciled divergence among its members on monetary measures that should be taken during the first stage. The report presents two options: on the one hand, a limited reduction of Community exchange margins should be undertaken during the first phase, supported either by a fund for exchange stabilization—the functioning of which is spelled out at length—or by coordinated intervention on the exchange markets by the central banks. Alternatively, such specific monetary action—perhaps both premature and too risky in the first phase—should be deferred in favor of further steps toward the harmonization of the economic policies and situations. The Council hopes that the Werner Group's final report in September will include suggested compromises.

Economic-Monetary Union and the British

Monetary problems are bound to play an important role in the negotiations on British accession to the Community, but there is so far little information on the respective negotiating positions. In general, the Commission's view is that, at the time of entry, the UK and the other candidates will have to take the same measures that the present EC countries have taken. In its March 1970 proposal, the Commission noted, moreover, that progress toward economic and monetary union could in fact help solve some of the problems that both the Community and the candidate countries will face as a result of the Community's enlargement. The British, for their part, have welcomed the moves the Community has already made toward economic and monetary integration and have expressed a readiness "to play our full part."

The problems for Britain in the monetary area are, in the first place, the adverse impact on its balance-of-payments that its participation in the Community may have—at least at the beginning. Although the British fully expect the long-run effects of accession to be beneficial, the initial influx of imports from the other Community countries, a possible outflow of British capital, and the contributions that London will have to make to the Community's financing could at the beginning cause sizable deficits. Secondly, there is the question of the sterling balances owned for the large part by members of the sterling area abroad. It is feared that these balances make Britain particularly vulnerable to speculative crises, although immediate concern on this score has lessened as a result of the 1968 Basle arrangements aimed at underwriting the value of the holdings. Various proposals involving consolidation of these overseas sterling balances, possibly combined with the creation of a European Reserve Fund, have been made in connection with Britain's joining the Community. Triffin, for example, argues that the Six individually already have to act as creditors for Britain in various international support arrangements and might as well make a virtue out of necessity by acting as a unit.

A reserve fund could also play a role in meeting the first problem—i.e., an early deficit on

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current accounts. Although there seems to have been little discussion yet at the Community level of the modalities of a reserve pool, it could support sterling during a transition period when Britain's reserves might be under pressure. On the other hand, the suggestions of Carli and others that British entry could be facilitated by the introduction of limited exchange-rate flexibility both on an international scale and, for an interim period, within the Community seem unlikely to get very far in view of the agreement among the Community members not to apply among themselves any widening of exchange rate margins that may be authorized at the international level. Moreover, those members that oppose adoption of greater international exchange-rate flexibility are likely to press the UK to take a similar position.

International Implications

The question of British support for the studies now under way within the International Monetary Fund on greater flexibility in international monetary exchanges is thus also closely linked with the UK's negotiations with the Community. Inasmuch as the US is interested in pursuing such studies at the international level and France is the chief opponent of introducing more flexibility, the British—aware that the outcome of the entry negotiations depends in large part on France—are to some extent caught in the middle of another potential US-French monetary skirmish. In any case, because the Community as a whole remains divided on international flexibility—with the Belgians siding with the French, and the Germans, Italians, and Dutch willing to consider the various proposals for moving away from fixed rates, it is clear that agreement in the IMF on exchange-rate reform will probably have to await a common Community position. A Commission official told the US mission in mid-July that the Community expects to reach a decision on this issue in the fall, but this may be optimistic.

Even if some consensus on principle were reached, it would seem that implementation of an international scheme would have to await further progress in the Community's achievement of economic and monetary union, as well as a commitment by Britain to its content and procedures. In order to move as a bloc vis-a-vis outside currencies in a world of greater exchange flexibility, the Six would have to achieve greater monetary unity among themselves. For example, are the Germans, who favor more international flexibility, yet ready for more monetary unity within the Community? Or are the French, who might be less opposed to international flexibility if it would lead directly to increased intracommunity solidarity, nevertheless willing to relinquish the degree of national monetary control required for movement toward such unity? Despite the delays the Community may cause, however, its proposed common economic and monetary policies are designed to foster stable relationships that would eliminate intracommunity problems as a potential source of international monetary crises.

Outlook

In any case, these complex questions may suggest not only the difficulty, but also the importance, of what the Community is trying to do. With the establishment of the customs union and the common market for agricultural products, the Community has emerged as the world's largest trading unit. As has been amply demonstrated already, the Community's commercial policy carries clout, and how that policy is made and by what Community interests it is influenced have become vital concerns of the international trading world. The Community's influence in international monetary affairs is potentially no less—provided it combines its resources, concerts its policies, and speaks with one voice. But whether the stabilizing potential of this development will be fully realized will likewise depend on who or what determines the Community's policies.

The problems and the opportunities the Community faces internally are comparably staggering. The Community's gross national product is already second only to that of the US. The

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instruments by which Washington gives the US economy direction and stability—the huge federal budget, the income tax, and the Federal Reserve system with its controls over credit policy, etc.,—materialized as the country grew, and as the federal system of government developed over a period of nearly two hundred years. Brussels is allowing itself a little over two decades to produce instruments that it hopes will be—if not comparable—at least reasonably effective. [redacted]

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